

GENERAL INFORMATION

The Community Reinvestment Act (“CRA”) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision to assess the institution’s record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution’s record of meeting the credit needs of its community.

This document is an evaluation of the CRA performance of the Fulton State Bank, Fulton, South Dakota, prepared by the Federal Reserve Bank of Minneapolis, the institution’s supervisory agency, as of December 8, 1997. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 228.

INSTITUTION’S CRA RATING: This institution is rated “Satisfactory.”

Several factors support rating the bank’s CRA performance satisfactory. First, the bank lends to borrowers of different income levels and to farms and businesses of various sizes. Its performance in this category is reasonable and meets the standards for satisfactory performance. Second, the bank’s net loan-to-deposit ratio relative to local competitors as well as its statewide and national peers is reasonable. Third, the distribution of the bank’s loans throughout its assessment area is also reasonable. Finally, the majority of bank’s lending activity is concentrated in the assessment area.

DESCRIPTION OF INSTITUTION

Based on its size and financial condition, the bank is able to meet the credit needs of its assessment area effectively. The bank was rated outstanding in helping to meet the credit needs of its community at its previous CRA evaluation. The bank operates a full-service office in Fulton, South Dakota, and has a branch office in Mitchell, South Dakota. The bank also owns and operates two automated teller machines ("ATM") in Mitchell. At the Mitchell branch ATM, users can withdraw and deposit funds; at the I-90 truck stop location, users can only withdraw funds. The bank has not opened or closed any branches since the last evaluation.

According to the bank's September 30, 1997, Report of Condition ("ROC"), the bank's assets totaled approximately \$22.9 million. Its September 30, 1997, ROC indicates the bank's major loan category is agricultural lending, which constituted approximately 53% of its loan portfolio. The balance of the bank's loan portfolio is composed of 30% commercial, 13% consumer, and 4% residential real estate loans. The composition of the bank's loan portfolio appears to reflect the level of demand for the specific types of loans in the assessment area.

The bank offers a variety of loan products to fulfill the needs of residents, businesses, and farms within its assessment area. Its loan products include conventional agricultural, commercial, consumer, and residential real estate loans. With respect to the latter loan category, the bank refers many residential real estate loan applicants to a financial institution in Brookings, South Dakota. The bank states it has the arrangement with the other institution to provide its customers with residential real estate loan products it is unable to offer effectively on its own.

In addition to offering conventional loan products, the bank participates in federal loan programs sponsored by the Rural Development Agency and Small Business Administration. Finally, the bank participates in government-guaranteed student loan programs.

The bank's loan products appear appropriate to fulfill the credit needs of residents, businesses, and farms in its assessment area.

DESCRIPTION OF FULTON STATE BANK'S ASSESSMENT AREA

The bank has defined its assessment area as Hanson and Davison counties in southeastern South Dakota. Based on the 1990 U.S. Census, the population for the assessment area is approximately 20,497. Hanson County is composed of a middle-income block numbering area ("BNA"), 9641. The bank's main office is located in Fulton, also located in BNA 9641. Fulton has a population of roughly 60 residents, and Hanson County's population is roughly 2,994. Davison County is composed of three middle-income BNAs, 9626, 9628, and 9629, and upper-income BNA 9627. Davison County has a population of approximately 17,503 and includes the city of Mitchell, which has a population of roughly 13,798. The bank's branch office in Mitchell is located in BNA 9629. Mitchell is located 11 miles west of Fulton and approximately 66 miles west of Sioux Falls, South Dakota. It is the county seat for Davison County and the largest community in the assessment area. Other communities in the assessment area include Alexandria, Emery, Farmer, Mount Vernon, Ethan, and Spencer.

CRA divides income levels into four categories: low, moderate, middle, and upper. Because the bank's assessment area is not in a metropolitan statistical area, the categorization of a borrower or BNA's income is determined relative to the most recently available statewide nonmetropolitan median family income. Low-income individuals have incomes of less than 50% of the statewide nonmetropolitan median family

income, while moderate-income individuals have incomes of at least 50% but less than 80% of this amount. The regulation defines a middle-income person as one with an income of at least 80% but less than 120% of the statewide nonmetropolitan median family income. An individual with an income that is 120% or more of the statewide nonmetropolitan median family income is considered an upper-income person. BNAs are classified using similar categories based on the level of the 1990 U.S. Census median family income in the geography. According to 1990 census data, the statewide nonmetropolitan median family income for the bank's assessment area is \$25,547. In 1997, the statewide nonmetropolitan median family income for South Dakota rose to \$34,500.

Based on 1990 census data, there are 8,065 households and 5,344 families in the assessment area. The following table summarizes the distribution of household and family incomes in the assessment area.

DISTRIBUTION OF ASSESSMENT AREA POPULATION BY INCOME LEVEL				
Unit of Measure	Low Income	Moderate Income	Middle Income	Upper Income
Households Compared to Median Household Income	22.5%	16.6%	20.3%	40.6%
Families Compared to Median Family Income	14.5%	18.8%	25.2%	41.6%

For purposes of comparison, the following table summarizes the distribution of household and family incomes for the nonmetropolitan areas of South Dakota.

DISTRIBUTION OF SOUTH DAKOTA NONMETROPOLITAN POPULATION BY INCOME LEVEL				
Unit of Measure	Low Income	Moderate Income	Middle Income	Upper Income
Households Compared to Median Household Income	23.6%	16.6%	18.9%	40.9%
Families Compared to Median Family Income	19.5%	18.0%	23.5%	39.0%

As shown in the two tables above, the percentage of assessment area low-income households and families is slightly lower than the representation of such households and families in South Dakota's nonmetropolitan areas. The percentage of moderate- and upper-income households and families is similar. With respect to middle-income households and families, the assessment area's percentages are slightly higher than South Dakota's nonmetropolitan areas.

The following table shows the percentages of households and families in the assessment area that have incomes below the poverty level.

	HOUSEHOLDS WITH INCOMES BELOW POVERTY LEVEL	FAMILIES WITH INCOMES BELOW POVERTY LEVEL
Assessment Area	16.3%	10.8%
South Dakota Nonmetropolitan Areas	17.9%	13.7%

The assessment area's percentages for household and family incomes that fall below the poverty level are slightly lower than those of the state's nonmetropolitan areas. According to the 1990 census, the unemployment rate for the assessment area was 3.9%, which is slightly lower than the state's nonmetropolitan area unemployment rate of 4.3%. The above data suggests that assessment area residents have the opportunity to enjoy a slightly better living standard than people residing in other parts of rural South Dakota.

The assessment area BNAs are designated as middle- or upper-income geographies based on comparison to the relevant state median family income. There is only one upper-income geography, BNA 9627, in the assessment area. Based on 1990 data, it has a median family income of \$31,983. All the remaining geographies are classified as middle income, and the median family income varies significantly among them. BNA 9626 has the lowest median family income in the assessment area of \$23,909, whereas BNA 9629 has the highest median family income of \$29,295. The only geography in Hanson County, BNA 9641, has the second highest middle-income median family income at \$28,232.

Both bank management and the community contact stated that 1997 had been an exceptionally good year for the area's agricultural industry. Major farm products consisted of corn and soybeans. Soybean crop yields this year were roughly 40 bushels per acre; the yearly average is typically around 30 bushels per acre. The price for soybeans toward the end of 1997 was around \$6.50 per bushel, which was an increase of approximately \$.25 per bushel since the beginning of the year. Similarly, corn yields for 1997 were 80 to 90 bushels per acre when the yearly average is roughly 65 to 70 bushels per acre. Corn prices started at \$2.10 per bushel and went to \$2.30 per bushel toward the end of the year. Livestock operations should also do well with cattle prices increasing. Although bank management noted that farming expenses are going up, they stated that 1997 should be a benchmark year for agriculture.

According to the South Dakota Agricultural Statistics Service, Hanson County ranked 21st in the state for corn and 22nd for soybean production for 1996. There are 66 counties in the state. Also in 1996, Davison County's state rankings were 19th for corn and 27th for soybean production. Based on a 1992 agricultural census, Davison County had 462 farms with a collective average size of 586 acres. The same census showed Hanson County had 353 farms with a collective average size of 695 acres.

Examiners contacted a representative of a local business association as part of the bank's CRA evaluation. The community contact provided information regarding the local business and agricultural economic conditions. Examiners used information from this contact as well as information from bank management to evaluate the bank's CRA performance.

Bank management and the community contact also stated that the economy in the area, especially around the city of Mitchell, is considered stable. For a radius of about 25 miles around Mitchell, the economy has stabilized. The city's population level is stable, but rural areas have been losing population. Due to low interest rates and the lower cost of capital, many manufacturing and retail establishments have undergone expansions or remodeling. The community contact stated this is evidenced by the increase in building permits in the Mitchell area. The community contact also noted that many franchised businesses have opened in Mitchell. Tourism is also highly sought, and Mitchell has increased the number of hotel rooms available for lodgers to roughly 800.

There are roughly 10,000 jobs in the county and 6,500 jobs in the city. The jobs in the city can be further classified as 2,000 in retail; 1,000 in health care; 1,700 in manufacturing; and the balance of approximately 1,800 in service, financial, government, and tourism industries. Mitchell is a considered a retail trading center and has shown a 2% to 3% annual increase in retail sales. Generally, there has been growth in the labor force in the area.

According to the county business patterns compiled by the U.S. Bureau of Labor Statistics, employment patterns in the assessment area have shown some changes. Between 1991 and 1995, the number of employees involved in manufacturing increased roughly 40%. Other area industries showing substantial increases in the number of people employed were construction, up 17%; services, up 16%; and retail trade, up 11%. Conversely, farming employment decreased 8%.

The community contact stated a major demographic change is how people make a living now versus 15 years ago. In the rural environment, less people work in farming or retail sales-related jobs. Increasing numbers of people are seeking employment in manufacturing-related jobs. The contact also stated the problem faced by the community is not unemployment but underemployment. The area's unemployment rate is less than 3%. According to the contact, major employers in the area include a hospital, the Mitchell school district, a truck trailer manufacturer, a meat processor, a retail grocery store, a metal products manufacturer, and a suspensions manufacturer.

As for housing, the contact indicated there has been roughly a 1% to 2% increase in the construction of residential housing for upper-income homebuyers. For the Mitchell area, the costs associated with building a house in the price range of \$65,000 to \$75,000 would not be profitable for a builder or developer. These costs include the purchase of a lot and providing the needed infrastructure, such as streets, curbs, electricity, gas, water, and sewer. However, houses in this price range would be the most attractive to low- and moderate-income homebuyers. The city has started a new housing program for low- and moderate-income buyers. A tract of land was purchased by the city and subdivided into parcels. The cost of a lot would be subsidized by the city through a block grant based on the income level of the prospective buyer. The purpose of the program is to bring down the cost to make the house more affordable. This lot price subsidy program began nine months ago, and it is too early to judge any results or the demand for this kind of subsidized housing. Additionally, low-income housing for the tract area is further subsidized by a private builder and programs sponsored by the U.S. Department of Housing and Urban Development.

The contact also indicated that another approach the city uses to make low-cost housing available is a "move-out" strategy to encourage elderly citizens to move to apartments or assisted-living facilities. It is a general belief that many elderly citizens occupy the older, smaller, and lower-cost homes in Mitchell. By making more appealing housing alternatives available, some elderly homeowners might be encouraged to move, thus making less expensive homes available for lower-income buyers.

Based on the 1990 census, 71% of the assessment area's homes are one-unit structures. Dwellings consisting of two to four units accounted for 7% of the assessment area's housing units. Likewise, dwellings consisting of five or more units accounted for 14% of the assessment area's housing units. Finally, mobile homes represented 7% of the assessment area's housing structures. As a percentage of housing units in the assessment area, 57% are owner occupied, 35% are rental, and 8% are vacant. Finally, roughly 42% of the housing was built before 1950.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's performance in meeting the assessment area's credit needs is satisfactory. Much of the analysis on the following pages is based on a statistical sample of 66 consumer, 72 small business, and 79 small farm loans originated by the bank during the six months preceding the evaluation. In assigning the overall rating, greatest weight was placed on the bank's level of lending to borrowers of different income levels and to farms and businesses of different sizes. This factor most closely measures the bank's efforts to meet the credit needs of all segments of its community.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's net loan-to-deposit ratio meets the standards for satisfactory performance. Based on quarterly ROC data, the bank's average net loan-to-deposit ratio since the previous evaluation is 65%. In comparison, the bank's quarterly average net loan-to-deposit ratio at the previous evaluation was 73%.

The following table, based on quarterly ROC data since the previous evaluation, shows that the bank's net loan-to-deposit ratio has ranged from 58% to 69%.

DATE	NET LOANS (IN THOUSANDS)	DEPOSITS (IN THOUSANDS)	NET LOAN-TO-DEPOSIT RATIO
September 30, 1996	\$13,169	\$19,477	68%
December 31, 1996	\$13,223	\$20,990	63%
March 31, 1997	\$12,906	\$22,105	58%
June 30, 1997	\$14,027	\$21,551	65%
September 30, 1997	\$14,197	\$20,682	69%

Since September 30, 1996, the bank's net loans and deposits have fluctuated, reflecting the normal business cycle of the bank's predominantly agricultural loan portfolio. A further comparison of net loan and deposit levels between September 30, 1996, and September 30, 1997, shows that net loans had increased approximately 8% while deposits had an increase of roughly 6%. Bank management attributed competition as a factor in the fluctuation of bank's level of deposits and loans since the last evaluation.

According to the June 30, 1997, Uniform Bank Performance Report, the bank's net loan-to-deposit ratio was 65.09%, which ranked the institution in the 39th percentile of its national peer group. As of the same date, the bank's net loan-to-assets ratio was 59%. The average net loan-to-assets ratio for South Dakota banks with total assets of \$25 million and less was 61.05%. This data indicates that the bank dedicates a smaller percentage of its assets to net loans than similarly sized banks operating in the state.

The bank is the smallest financial institution operating in its assessment area. The bank's average net loan-to-deposit ratio is lower than the ratio of the two largest competitors. Nonetheless, it appears reasonable in light of the ratios for all the banks operating in the assessment area. The following table identifies the asset size and quarterly average net loan-to-deposit ratio for the bank and several of its competitors based on the quarterly ROC data from June 30, 1996, to June 30, 1997.

BANK AND LOCATION	TOTAL ASSETS (AS OF SEPTEMBER 30, 1997) (IN THOUSANDS)	QUARTERLY AVERAGE NET LOAN-TO-DEPOSIT RATIO
Fulton State Bank Fulton, South Dakota	\$23,753	65%
Commercial Trust & Savings Bank Mitchell, South Dakota	\$176,879	78%
CorTrust Bank Mitchell, South Dakota	\$171,966	79%
Security State Bank Alexandria, South Dakota	\$40,854	65%
The Security State Bank Emery, South Dakota	\$24,733	61%

As the data in the table illustrates, two of the four banks listed have higher average quarterly net loan-to-deposit ratios than the subject bank. It should be noted that these two banks are significantly larger institutions. Within the assessment area, the only bank with a comparable asset size has an average net loan-to-deposit ratio slightly lower than the subject bank. In addition to the institutions mentioned above, there are branch offices of two large regional banks headquartered in Sioux Falls, South Dakota, in Mitchell and a branch of a federal savings bank headquartered in Beresford, South Dakota. Finally, there are two credit unions and several offices of nonbank investment brokers in Mitchell. Loan and deposit information for these entities were not available.

As reflected in the table above, it appears the demand for credit in the assessment area is fair. This is based on the loan-to-deposit level of the listed banks. However, it is apparent that the assessment area's financial market is very competitive, and local banks are willing to extend credit to fulfill the needs of local residents, farms, and businesses. The community contact confirmed that there are no unmet credit needs in the assessment area. The community contact also stated the larger financial institutions seem to have the resources to understand and handle more effectively the paperwork associated with the more complex types of lending, such as commercial and real estate.

Therefore, based on the bank's net loan-to-deposit ratio relative to local competitors as well as its statewide and national peers, the bank's net loan-to-deposit ratio is reasonable and meets the standards for satisfactory rating.

DISTRIBUTION OF CREDIT WITHIN THE ASSESSMENT AREA

The distribution of the bank's loans within the assessment area is reasonable. A review of the statistical sample of consumer, small business, and small farm loans originated by the bank reveals that it extends a majority of its loans inside the assessment area.

The following table shows the percentage of loans within the assessment area based on total number and dollar amount in each major loan category.

LOANS IN THE ASSESSMENT AREA		
Major Loan Product Line	Total Number of Loans	Total Amount of Loans
All Consumer	77%	75%
Small Business	94%	96%
Small Farm	62%	56%

The bank's small business loans are highly concentrated in the assessment area; this is primarily due to the concentration of businesses in the Mitchell area. The data also reveal that the bank extends many small farm and consumer loans to borrowers who reside outside the assessment area. One factor bank management attributed to this situation is that some customers have moved from the area but continue to maintain a borrowing relationship with the bank. Also, review of loan data indicates the bank has borrowing customers who reside in communities and areas just outside the assessment area.

Based on the concentrations of loans within the assessment area, the bank's lending performance meets this category's standards for satisfactory performance.

LENDING TO BORROWERS OF DIFFERENT INCOME LEVELS AND TO BUSINESSES OF DIFFERENT SIZES

The bank's level of lending to individuals of different incomes and to farms and businesses of different sizes meets the standards for satisfactory performance. As discussed previously, CRA classifies borrower income levels into four categories: low, moderate, middle, and upper.

As mentioned earlier, the data used to evaluate the bank's CRA performance are based on a statistical sample of consumer, small business, and small farm loans originated in the six months preceding the evaluation. However, income data for the bank's consumer loan borrowers were available for only 53% of the sampled loans. Nevertheless, information derived from a review of the bank's consumer loans should provide a fairly reasonable indication of the bank's performance in this category. However, since this percentage of loans with income data available represents only a slight majority of the loans sampled, this analysis is given less consideration in the rating of the bank's performance in this category. As discussed in the Description of Institution section, the dollar amounts of small farm and small business loans constitute approximately 53% and 30%, respectively, of the bank's total loan portfolio, while consumer loans comprise roughly 13% of the bank's loan portfolio. Therefore, the bank's performance for this category is evaluated based primarily on the small business and small farm loan data, with lesser consideration given to the consumer loans.

Reflecting the nature of the local agricultural market, all the sampled small farm loans were to operations grossing less than or equal to \$1 million in annual revenues. Small farm loans as defined by the ROC are loans with original amounts of \$500,000 or less; all of the bank's agricultural loan originations during the CRA sample period were to small farm loans. Of these loans, 96% were for amounts less than or equal to \$100,000 and 4% were for loan amounts of more than \$100,000 and less than or equal to \$250,000.

Additionally, all the sampled small business loans were to establishments grossing less than or equal to \$1 million in annual revenues. The majority of the small business loans originated were at the Mitchell branch office. Small business loans as defined in the ROC are loans with original amounts of \$500,000 or less; and all of the bank's commercial loan originations during the sample period were small business loans. Of these loans, 99% were for amounts less than or equal to \$100,000 and 1% are for loan amounts of more than \$100,000 and less than or equal to \$250,000. The concentration of small farm and small business loans in the bank's loan portfolio appears to reflect the bank's asset size, legal lending limit, and local agricultural and commercial market

The following table shows the percentage of consumer loans made to borrowers of different income levels.

DISTRIBUTION OF LOANS IN THE ASSESSMENT AREA* BY BORROWER INCOME LEVEL				
Loan Type	Low Income	Moderate Income	Middle Income	Upper Income
ALL CONSUMER LOANS				
Percentage of Number of Loans	33%	19%	41%	7%
Percentage of Amount of Loans	19%	25%	50%	6%
*Income level is determined based on the 1997 South Dakota nonmetropolitan median family income of \$34,500.				

As shown above, the bank extended 52% of its consumer loans to low- and moderate-income borrowers. According to the 1990 census data, low- and moderate-income households and families comprise 39.10% and 33.3% of the assessment area population, respectively. More specifically, low- and moderate-income households represent 22.5% and 16.6% of the assessment area's population, respectively. The respective percentages for the assessment area's low- and moderate-income families are 14.5% and 18.8%. Based on the loan data, the bank's consumer lending to low- and moderate-income borrowers appears to be considerably higher than the given representation of such households and families in the assessment area.

As mentioned previously, the consumer lending evaluation is based on current available income data from 53% of sampled consumer loans. It is the bank's practice to obtain current credit information for new accounts or if the credit applicant has not established a credit history with the bank. Since consumer income data was derived from consumer loans originated within the last 12 months, it appears that the majority of consumer loans are to new customers with low and moderate incomes. The bank is also willing to extend credit to borrowers for low-dollar amounts. This is noteworthy considering the competitive banking environment in which the bank operates.

The bank is willing to extend loans to businesses and farms of various sizes and to borrowers of different income levels. All the bank's small farm and business loans were to entities that have gross annual revenues of \$1 million or less; however, this is expected given the economic and agricultural market in which the bank operates. Further, its consumer lending activity appears reasonable given the assessment area's demographics. Considering the bank's level of loans to low- and moderate-income borrowers as well as small farm and business loans to entities with gross annual revenues of \$1 million or less, the bank meets this category's standards for satisfactory performance.

GEOGRAPHIC DISTRIBUTION OF LOANS

The distribution of the bank's loans in its assessment area is considered reasonable and meets the standards for satisfactory performance. As previously discussed, the bank's assessment area is composed of middle- and upper-income BNAs; it does not have any low- or moderate-income geographies. The following table shows the percentage of loan penetration in each BNA in the bank's assessment area.

LENDING ACTIVITY BY GEOGRAPHY						
	Consumer Loans		Small Business		Small Farm	
BNA	Number	Amount	Number	Amount	Number	Amount
9626	-0-	-0-	-0-	-0-	6%	1%
9627	16%	8%	10%	23%	2%	7%
9628	27%	24%	71%	24%	12%	4%
9629	16%	28%	10%	32%	-0-	-0-
9641	41%	40%	9%	21%	80%	88%
Total	100%	100%	100%	100%	100%	100%

The loan data indicate the bank extends the majority of its consumer and small farm loans in BNA 9641, which represents Hanson County, and is the location of the bank's main office in Fulton. The area with the second highest level of loan penetration is BNA 9628, which is located in Mitchell. As discussed previously, the majority of small business loans were originated by the Mitchell branch office. The geography with the lowest level of loan penetration is BNA 9626, which is just west of Mitchell and is sparsely populated. In addition, that geography has the lowest median family income percentage.

Generally, the concentration of lending across geographies in the assessment area reflects the BNA's demographics and their population size relative to the entire assessment area. It also appears that the bank's loan activity in these areas is a function of proximity. Other financial institutions are located between these geographies and the bank.

The bank's loan penetration throughout the assessment area is reasonable given the bank's size as well as the assessment area's size and demographics. Therefore, the bank meets the standards for satisfactory performance in this category

GENERAL

The evaluation did not reveal any violations of the substantive provisions of the fair housing and fair lending laws and regulations; however, it did reveal isolated violations of the technical aspects of the Equal Credit Opportunity Act's Regulation B. During the evaluation, management promised to correct the noted violations.

The bank has not received any CRA complaints since the last evaluation.

PUBLIC DISCLOSURE

December 8, 1997

Date of Evaluation

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Fulton State Bank

Name of Depository Institution

094605900000

Identification Number of Institution

Fulton, South Dakota

Address of Institution

Federal Reserve Bank of Minneapolis
90 Hennepin Avenue
Minneapolis, Minnesota 55401-1804

NOTE: This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.